1 of 2 DOCUMENTS

The Wall Street Journal

January 16, 2008 Wednesday

SECTION: Pg. A1

LENGTH: 2436 words

HEADLINE: World Rides to Wall Street's Rescue --- Citigroup, Merrill Tap Foreign-Aid Lifelines; Damage Tops $90 Billion

BYLINE: By David Enrich, Robin Sidel and Susanne Craig

BODY:

In the latest sign of America's sinking financial fortunes, investors from as far afield as Japan, Korea, Singapore, Saudi Arabia and Kuwait have come to the rescue of Wall Street.

The list of players that agreed yesterday to pump a combined $19.1 billion of capital into Citigroup Inc. and Merrill Lynch & Co. spotlights a dramatic shift in power. After flooding the world with capital that fed both economic growth and excess, battered U.S. financial institutions now are turning to countries and companies that not so long ago were suffering through their own disasters.

Yesterday's infusions follow earlier investments into wounded American and European titans, including Morgan Stanley and UBS AG. The bailout is another milestone in a long-running trend: the subsidization of the U.S. economy by foreign investors, from Asian governments purchasing U.S. Treasury bonds to finance the national debt to deep-pocketed oil states snapping up stakes in hobbled banks.

"There are quite a few ironies there," says Anthony Sabino, a professor of law and business at St. John's University in New York. "Traditionally, it is the U.S. economy and the wealth of the U.S. that have come to the rescue of nations and businesses across the world."

Merrill's investors, which were announced yesterday, include Mizuho Financial Group Inc., the second-largest Japanese bank, which was nearly swamped by bad loans made in the 1990s. Korean Investment Corp., another Merrill investor, is a government-controlled investment fund of South Korea, a country that was staggered by the Asian financial crisis in the late 1990s.

The reason titans like Merrill and Citigroup have had to go hat-in-hand for money: big losses from bad bets tied to the battered U.S. housing market.

Citigroup, which yesterday announced a fourth-quarter loss of $9.83 billion, said it would write down the value of certain assets by $18.1 billion. Merrill's fourth-quarter write-downs, to be announced tomorrow, are expected to be nearly $15 billion. That will push the toll on Wall Street from the current credit crisis past $100 billion in losses, equivalent to 0.7% of gross domestic product. By way of comparison, the total losses from savings and loans and related commercial bank loans from 1986 to 1995 were about $189 billion, or 3.2% of average GDP in that period. S&Ls alone were $153 billion.

Despite their problems, neither Citigroup nor Merrill had trouble luring investors, including one U.S. pension fund and firms drawn to appealing terms such as the 9% dividend Merrill promised on $6.6 billion in preferred stock that it will issue. Citigroup will pay a 7% dividend on $12.5 billion in preferred shares.

"There are trophy properties available for what is petty cash," says Claire Gruppo, co-founder of Gruppo Levey & Co., which advises government investment funds.

Former Citigroup Chairman and Chief Executive Sanford Weill, who is adding to his already large stake in the New York financial conglomerate, said a total of about $20 billion raised so far by Citigroup "goes a long way to shore up losses." He added that "many parts of the company are doing very well."

Vikram Pandit, who became Citigroup's chief executive last month, said the moves announced yesterday "allow us to be on our front foot," using a cricket term for being well positioned.

Despite the billions of dollars in fresh capital, it isn't certain that either Merrill or Citigroup are out of the woods. Credit markets are still performing poorly, and consumers continue to tangle with mortgages carrying interest rates that will adjust upward this year. Furthermore, Citigroup faces big exposure to the consumer-credit cycle, which is showing increased signs of weakness. The big bank has a massive credit-card portfolio that includes subprime cardholders who are likely to find it increasingly difficult to pay their bills.

Financial stocks skidded yesterday on deepening fears that credit problems are spreading beyond mortgages and into credit cards, auto loans, commercial loans and other types of credit. Citigroup helped fuel the sell-off with bearish comments and $4 billion in fourth-quarter credit costs in its U.S. consumer business.

So far, the foreign investment in Wall Street firms hasn't provoked a political backlash in the U.S., in contrast to the uproar that followed Dubai Ports World's attempt to acquire the operations of U.S. ports last year. The Dubai Ports World incident raised anxiety about undermining U.S. defenses against terrorism.

The injections of foreign capital into the two Wall Street giants emerged as an issue in last night's debate among the leading Democratic presidential hopefuls. "I'm concerned about this," New York Sen. Hillary Clinton said, invoking the phrase "sovereign wealth funds." "We've got to know more about them, they've got to be more transparent . . .," she said. "I want the United States Congress and the Federal Reserve Board to ask these tough questions."

Politicians may be aware that the alternative to foreign investment in the banking system could be painful. If banks pull back on lending, that would have negative consequences to the economy. The issue of selling chunks of Wall Street to Middle Eastern and Asian investors hasn't figured much in political campaign rhetoric -- perhaps because voters don't care much about who owns shares in Citigroup or Merrill Lynch.

"What we've seen so far has been largely constructive. We need the money," said Massachusetts Democrat Barney Frank, chairman of the House Financial Services Committee. "Given that we had the losses, the infusion of money is helpful. . . . We'd be worse off without it."

But the long-term implications are uncertain. Foreigners, including the investment arms of some governments criticized as autocratic, will end up with a significant chunk of Wall Street. Existing shareholders will see their stakes diluted.

Merrill's capital-raising efforts began in October, after its devastating third-quarter write-down and just weeks before Merrill Chairman and Chief Executive John A. Thain arrived. At the board's behest, senior management led by Gregory Fleming, an investment banker specializing in financial institutions and now the firm's president, began assembling a list of possible investors, according to people familiar with the matter.

In December, the firm lined up an immediate $4.4 billion injection from Singapore's state-run Temasek Holdings. But Mr. Thain and others figured the firm would need another $5 billion or so. Given the strong response of investors, they decided to raise more, says one person involved in the discussions with investors.

"We didn't make any outbound calls on this," this person says. All investors involved in yesterday's announcement indicated they would have invested more if they could have, and some ended up investing less than offered, this person says.

"We contacted them," says William G. Clark, director of the New Jersey Division of Investment, which agreed to invest $400 million in Citigroup and $300 million in Merrill Lynch. Mr. Clark approached both firms about a week ago, after reading press reports suggesting that they were looking for additional capital.

Most of the Merrill money is coming from overseas. Korean Investment Corp., Kuwait Investment Authority, and Mizuho Financial Group account for about 80% of the $6.6 billion raised, says the person involved in the discussions.

Mizuho's investment of $1.2 billion is the biggest international move by a Japanese bank since 1986, when Sumitomo Bank Ltd., one of the predecessors of Sumitomo Mitsui Financial Group Inc., bought a $500 million stake in Goldman Sachs, then a private partnership that was fighting to compete with better-capitalized rivals. Sumitomo went on to make $1.9 billion on the investment. When Sumitomo found itself short of cash in 2003, Goldman pumped $1.3 billion into the bank, solidifying the relationship between the two institutions.

Until recently, Japanese banks like Mizuho have largely shied away from big overseas investments, focusing on beefing up their domestic businesses. But these banks are now looking to boost their overseas operations. "We'd like to see if the [Merrill deal] could lead to cooperation between the two firms in different business areas," says a Mizuho spokeswoman.

Merrill is hoping to form strategic alliances with each of the big foreign firms, says a person familiar with the matter.

The large reservoirs of capital available to Citigroup and Merrill are a marked contrast to past banking crises. In 1991, it took Citigroup several months of hard searching before Saudi Arabian Prince Alwaleed bin Talal agreed to pump $590 million into what was then known as Citicorp. The investment, in the form of a private placement of convertible preferred stock, gave him an ownership stake of nearly 15% at the time.

This time, the day after Citigroup unveiled in late November a $7.5 billion investment from the Abu Dhabi Investment Authority, known as ADIA, representatives of other investment firms started calling Citigroup.

"A lot of the equity investors were upset after the ADIA investment because they felt they didn't get a bite of the apple," says one person with knowledge of the situation. Capital Research Global Investors, already one of Citigroup's largest institutional investors, was among the most vocal investors, this person says.

Between Christmas and New Year's Day, a small group of senior Citigroup executives started hammering out that second round of fund raising. Citigroup needed fresh cash to keep its capital levels from dipping into dangerously low territory.

The group included Mr. Pandit, Citigroup's new chief executive officer; Chief Financial Officer Gary Crittenden; investment banking co-head Michael Klein; and Zion Shohet, Citigroup's treasurer. They started reaching out to

investors that hadn't taken part in the ADIA deal.

Their pitch was simple: Investors would have the chance to snap up significant stakes in Citigroup at half the price it would have cost them before the credit crunch hit last summer. Citigroup executives gave detailed briefings on the company's planned fourth-quarter announcements, including the expected dividend cut and the rough magnitude of the write-downs.

Other Citigroup executives, including Hamid Biglari, a senior deal maker responsible for the investment bank's dealings with financial institutions, reached out to the China Development Bank, an institution with ties to the Chinese government. They tentatively reached an agreement last week in which CDB would invest about $2 billion in Citigroup. But last weekend the deal fell through after it encountered resistance from Chinese regulators.

The setback proved fleeting, as the Government of Singapore Investment Corp., known as GIC, kicked in extra funding to compensate for China's withdrawal. GIC ended up as by far the largest investor, pouring in about $6.9 billion, slightly more than half of the total infusion. The next largest contributor, the Kuwait Investment Authority, put in "a fraction" of what GIC invested, says a person familiar with the matter. None of the investors will own more than 4.9% of Citigroup's stock, allowing them to avoid added scrutiny from U.S. bank regulators.

While Citigroup didn't disclose the size of the other investors' stakes, the contributions were relatively small. One person close to the situation described the investments by Mr. Weill and Prince Alwaleed as "tiny little pieces" of the overall $12.5 billion investment.

In recent days, Mr. Pandit reached out to Mr. Weill and asked him if he'd like to participate. Citigroup didn't need his cash. But executives were eager for Mr. Weill to invest because it would send a signal that he endorsed the bank's management and strategy, says a person familiar with the matter.

Mr. Weill had built Citigroup into a financial colossus. His handpicked successor, Charles Prince, had recently stepped down amid mounting losses, and Mr. Weill's strategy of a universal bank has increasingly been called into question. Mr. Pandit was willing to use Mr. Weill as a sounding board about Citigroup's problems. Mr. Weill offered to be an investor, and dealt directly with Mr. Pandit.

As Citigroup executives came to terms with the size of the looming fourth-quarter loss -- the largest quarterly loss in Citigroup's history -- the need for billions of dollars in fresh capital became obvious.

In the third quarter, Citigroup's Tier 1 capital ratio -- a key measure of its ability to withstand losses and continue serving its customers -- had already dwindled below the company's internal target levels, prompting Citigroup to stop repurchasing its own shares.

The investments announced yesterday will go a long way toward mending the tattered capital ratios. With that and other cash in its pocket, Citigroup estimates its Tier 1 ratio will rebound to 8.2%, safely above its internal target and regulatory minimums.

The danger is that further write-downs will continue to chip away at capital. Even after reducing their value by $18 billion, Citigroup still is exposed to $37.3 billion of collateralized debt obligations, or CDOs, complex investment vehicles whose values have cratered as mortgage defaults have soared.

Citigroup continues to assign higher average values than others in the industry to the rarely traded instruments, analysts say. As a result, "more CDO hits could be in store," says David Hendler, an analyst at CreditSights Inc.

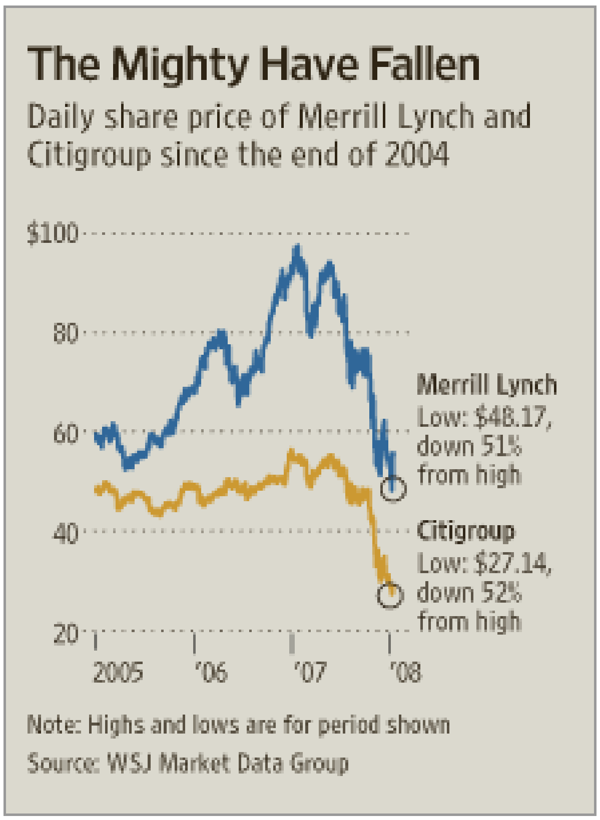
The company's U.S. consumer business could be another source of pain. Citigroup surprised Wall Street yesterday by taking a $4.1 billion hit in order to set aside more money to cover possible future defaults on mortgages, home-equity loans, credit cards and auto loans -- areas in which the bank is seeing more borrowers fall behind on

payments.

Citigroup said those beefed-up reserves should be enough to cover 22 months worth of loan losses -- as long as they stay at current levels. But many industry observers expect a leap in defaults on credit-card and auto loans, where credit quality so far has remained solid. If that happens, Citigroup likely will be forced to bite the bullet and set aside additional reserves.

Monica Langley, Craig Karmin, David Wessel and Yuka Hayashi contributed to this article.

(See related article: "Broad Market Still Worried; Dow Falls 2%" -- WSJ Jan. 16, 2008)



License this article from Dow Jones Reprint Service

NOTES:
PUBLISHER: Dow Jones & Company, Inc.

LOAD-DATE: January 16, 2008